Transnationals

Quarterly Newsletter
of the Centre on
Transnational Corporations

INVESTMENT FLOWS $225 BILLION IN 1990

World-wide outflows of foreign direct investment approached $225 billion in 1990, recording a growth of 7 per cent over 1989 but a decline of nearly 14 per cent from the annual growth rate for the 1980s. Recessionary conditions in developed market economies, but particularly in the United States, were largely responsible for the slow-down.

The continued growth in outflows throughout 1990, however, suggests that transnationals may be becoming less influenced by cyclical economic fluctuations and more tuned to long-term global strategic objectives.

Comparisons with domestic investment, domestic output, trade and technology flows further illustrate the recent dynamism of foreign direct investment. In both developed and developing countries, inflows grew almost four times as fast as domestic output and more than twice as fast as domestic investment during 1985-1990. Global flows increased about two and a half times faster than exports and one and a half times faster than royalties and fees receipts. In 1989, estimated sales by foreign affiliates world-wide were $4.5 trillion, underlining their importance as suppliers to world markets. In comparison, world exports were only about $3 trillion.

Firms Pursuing Longer-term Goals

In the past, foreign direct investment levels have generally moved in tandem with cyclical fluctuations in the global economy. Strong growth rates

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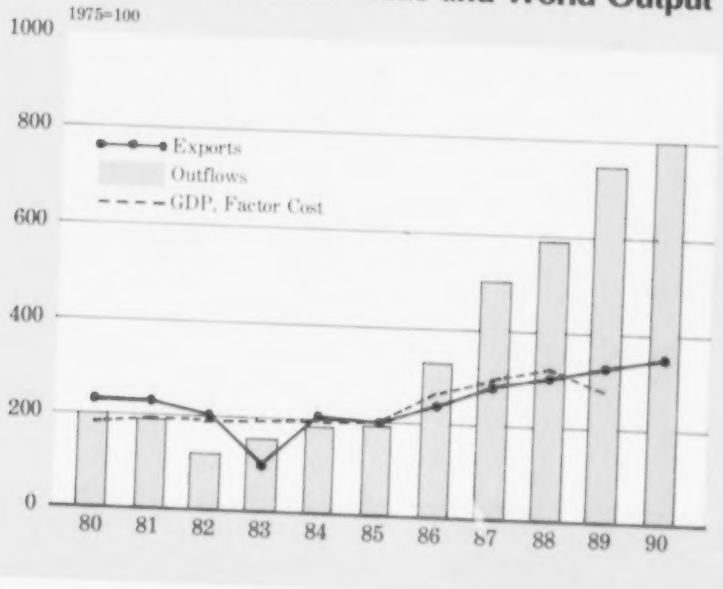
Investment Leads Trade and World Output



Building Public-Private Sector Synergies

The Centre on Transnational Corporations and the United Nations Division of Development Administration will now work together as the Transnational Corporations and Management Division. One of eight units in the United Nations Department of Economic and Social Development, the new Division will build on existing complementarities to strengthen the move to market forces.

Hamdan Benaissa, a lawyer by profession and a United Nations official with almost 30 years experience in technical assistance

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Investment Flows

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in gross national product were matched by expanding outflows, and recessions by decline. During the last major recession in the early 1980s, average annual investment flows dropped by about $13 billion. When it ended, flows surged exponentially.

According to the 1990 data, transnationals appear to be less influenced by short-run economic slowdowns and seem to be pursuing long-term goals. Global expansion is required to strengthen competitive advantages in penetrating new markets or boosting market share. The expansion by transnationals in Central and Eastern Europe, despite severe weaknesses in many of the economies in the region, is testimony.

Jump in Investments from Germany and France

Outflows from three of the five largest home countries — Japan, the United Kingdom and the United States — slowed considerably in 1990. The slowdown was partially offset by a surge in flows from Germany and France. German investments expanded by about 60 per cent from their 1989 levels. Investments from France jumped 85 per cent in response to policy changes that stimulated a substantial growth in crossborder mergers and acquisitions by national firms.

Among developing countries, most striking was the emergence of the Republic of Korea and Taiwan Province of China as net exporters of investment in 1990. Overall, however, outflows from developing countries declined in 1990 compared with 1989.

Inflows to United States Drop

In the United States, the onset of recession made investments less profitable. Inward flows plummeted by nearly 50 per cent, from $71 billion in 1989 to $37 billion in 1990. Recession in the United Kingdom and larger domestic investment by Japanese corporations were among the prime factors contributing to the drop. Both are major investors in the United States.

Preliminary estimates also indicate that in 1990, after a period of rapid growth and expansion,

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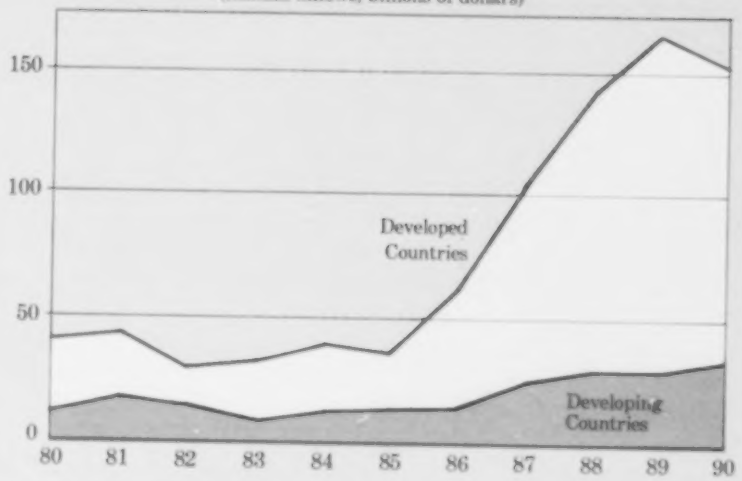
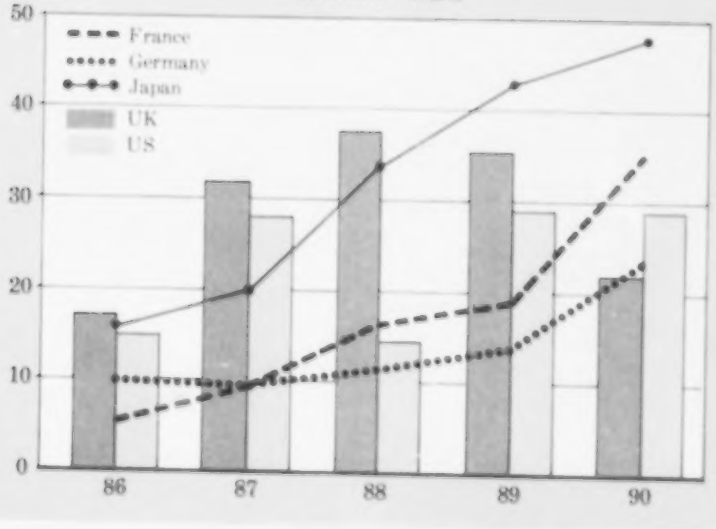
Foreign Direct Investment, 1980-1990

(Annual inflows, billions of dollars)



Investment Outflows from Home Countries

(Billions of dollars)



Transnationals may be becoming less influenced by cyclical economic fluctuations and more tuned to long-term global strategic objectives.

Investments to Latin America Pick Up

After nearly a decade of stagnation, the economies of Latin America and the Caribbean are witnessing a resurgence in foreign direct investment inflows. The region attracted investments of $10 billion in 1990, an increase of $1.7 billion from their 1989 level.

The level of investment inflows for the four largest host countries — Brazil, Argentina, Chile and Venezuela — doubled over the 1989-1990 period. Although investments into Mexico declined somewhat, a number of factors point to their rapid expansion in 1991. For example, new investment approvals reached a record high of $14 billion in 1991, and inflows are estimated to exceed $4 billion.

The revival of foreign investment in Latin America and the Caribbean is linked to renewed economic growth in a number of countries. Stronger efforts at regional economic integration and market-oriented policy reforms have lowered trade barriers and allowed foreign investors greater access to the region's resources and markets. In Argentina, the privatization of public corporations in 1990 led to inflows of new funds reaching nearly $1 billion.

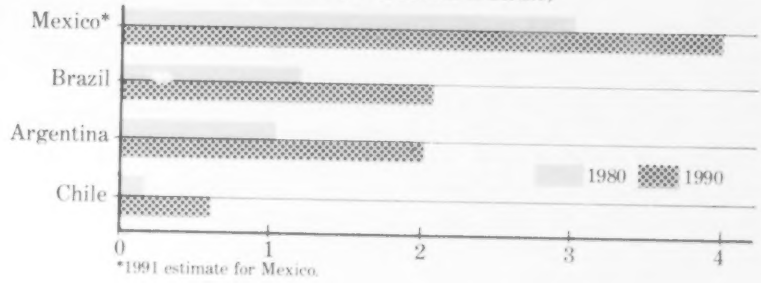
Debt-for-equity swaps have also been important in facilitating foreign investment flows, especially in Chile, Brazil and Venezuela. During the period 1985-1989, the share of debt-equity swaps in total capital flows was 80 per cent in Chile and 59 per cent in Brazil.

The proposed North American Free Trade Agreement and the Bush Initiative, designed to facilitate trade and investment and reduce foreign debt, will further enhance the locational advantages of Latin American and Caribbean economies for foreign investors, a process already underway. Majority-owned foreign affiliates of companies from the United States plan to increase capital spending by 20 per cent in 1991 in Mexico, up from a 6 per cent planned increase in December 1990, in response to the proposed free trade agreement and an improving investment climate.

Capital markets have become increasingly important in attracting foreign capital in some Latin American economies. The easing of exchange controls and removal of some restrictions on foreign participation in securities markets have significantly boosted the rapid growth of equity investments (and possibly the growth of foreign direct investment) to Latin American economies. ■

Increasing Flows to Latin America

(Annual inflows, billions of dollars)



*1991 estimate for Mexico.

Transnationals Boost Mexican Exports

As foreign investment in Latin America has revived, so have exports. In Mexico, foreign sales of manufactured goods more than tripled between 1982-1990. Primarily responsible, finds a new CTC study, were a handful of Mexican affiliates of large transnationals.

The 63 largest manufacturing affiliates accounted for 42 per cent of all manufactured exports in 1987. Four subsidiaries in the automotive industry — General Motors, Ford, Chrysler and Volkswagen, and two computer subsidiaries — Hewlett Packard and IBM — accounted for 28 per cent of the total. Over four fifths of all exports from the 63 largest affiliates in 1987 — or 35 per cent of total Mexican exports — was within firms. More than half the affiliates subcontracted locally, with considerable benefits to the local economy.

Performance requirements on exports and local content were important in pushing firms to stress exports and domestic suppliers. In return, they were granted special access to the large and protected Mexican market.

A North American Free Trade Agreement would be very timely for Mexico concludes the study, *Foreign Direct Investment and Industrial Restructuring in Mexico*. Industrial restructuring is already in full swing. Trade liberalization would bring down prices for domestic consumers. And with assured access to the North American market, Mexico may attract a growing share of foreign investment in coming years.

Foreign Direct Investment and Industrial Restructuring in Mexico. United Nations publication, Sales No. E.92.II.A.9. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.

Tapping Development Opportunities from Globalization

"Globalization is forcing Governments to put competitiveness high on the political agenda. As a result, Governments and transnationals are being forced to work together to achieve their own ends", said John Dunning, Professor at the Universities of Rutgers and Reading and a pioneer in the field of foreign investment research, to a symposium of leading experts, policy makers and corporate executives, meeting in The Hague on 30 March 1992.

In a pattern he described as "heterarchies", parent companies are increasingly incorporating subsidiaries into their decision making. This more horizontal relationship contrasts with traditional

Bernard Chidzero

corporate hierarchies. In it, there are growing opportunities for developing countries. Through networking and investment promotion, they must identify them and learn to build on them. Bernard Chidzero, Minister of Finance of Zimbabwe, agreed. "Global subcontracting", he said, "is likely to pull foreign direct investment to poorer countries, including those in Africa".

Openness Is the Key Issue

Given recessionary global conditions and unfavourable exchange rates, it is unlikely that foreign direct investment will continue to grow as explosively as in the 1980s,

Louka Katseli

held Louka Katseli, Professor at the University of Athens. DeAnne Julius, chief economist at Shell Petroleum, was more positive. "Future trends cannot be a mere extrapolation of past events. Given dramatic policy reversals in developing countries recently, there is reason for optimism". Moreover, though the volume of investment in developing countries has grown slowly, transnationals' involvement has jumped through a myriad of non-equity links, subcontracting and licensing.

According to Larry Westphal, Professor at Swarthmore College, Pennsylvania, the key issue in foreign direct investment is not of money crossing borders, but a whole host of other knowledge-based inflows and collaborations. "What really matters is the open-

DeAnne Julius

John Dunning, Louis Emmerij (OECD Development Centre), Ruman Faruqi (International Finance Corporation), Charles Frank (General Electric Capital), and Eveline Herfkens (World Bank).

Larry Westphal

ness of one's economy and how a country uses what it gets from foreigners", he said.

Some underlying policy conditions are key, stressed Moeen Qureshi and Ibrahim Shihata of the World Bank. Economic and political stability are first, entailing level exchange and inflation rates and the absence of nationalization threats or excessively high taxes. Second is deregulation,

Moeen Qureshi

liberalization and an opening to greater international competition. Then come a shifting from interventionist government policies and a greater role for the private sector. Also key, emphasized participants, is the need for a strong political will to ensure the success of such reforms.

If macroeconomic reform is not sufficient to attract investment, Governments may have to take specific supportive steps to help domestic firms upgrade production and penetrate new markets. Governments can adopt sectoral targeting or encourage specific sectors. Among the chief priorities in the next few years will be infrastructure development, the creation of appropriate labour skills, promoting the development of endogenous technological capability, and dealing with environmental issues. Measures to alleviate poverty will also be important, because poverty inhibits growth. Neither is it fully eliminated by growth.

The main point in foreign direct investment is not of money crossing borders, but a whole host of other knowledge-based inflows and collaborations.

Policies should aim to enhance local technical capacities and break into global technology and marketing networks. This formula could go a long way in boosting developing country competitiveness and attractiveness to foreign investors.

Participants agreed on the need for better and more targeted propagation of information about investment opportunities in developing countries. This is an area where chambers of commerce, industry associations and other private sector organizations could play a definitive role.

It is also important that economic regionalization not lead to fragmentation of the multilateral trading system. "Regional blocs are building blocks, not stumbling blocks", explained Robert Lawrence, Professor at Harvard University. It is through such arrangements, in which transnationals play a central role, that developing countries can tap into global markets. However, regional agreements should be as outward looking as possible, cautioned Richard Lipsey, Director of the Economic Growth and Policy Programme of the Simon Fraser University in Vancouver. Their tariffs should be as low and as equal as possible. Also they should be free trade areas rather than protectionist customs unions.

Completing the Uruguay Round is the most concrete step developed countries could take in support of a new investment regime.

Ibrahim Shihata

Participants stressed that completing the Uruguay Round was the most concrete step developed countries could take in support of a new investment regime. It would do much to create a stable trading environment.

The symposium, "Globalization and Developing Countries: Investment, Trade and Technology Linkages in the 1990s", was organized by CTC and the Ministry of Foreign Affairs of the Netherlands. ■

Mongolia Privatizes

In mid-January Mongolia enacted a new constitution, formally ending 70 years of Marxism, assuring multi-party democracy and a market economy. A massive programme of privatization is already underway, governed by the Privatization Law of May 1991. Sixty-five per cent of all state enterprises will be up for sale in the next few years.

The Foreign Investment Law of May 1990 allows investors to own up to 100 per cent of equity. Investments are protected against nationalization and profits may be remitted abroad freely. After an initial three-year tax holiday, taxes may not exceed 40 per cent of profits. Investors may also buy stock, and a special committee is working to set up an exchange. In the interim, shares from 25 companies are being sold through bank branches.

Target Sectors

- Mining
- Oil and petroleum
- Machine tools
- Chemicals
- Livestock and dairy
- Food processing
- Tourism

The aim is to put in place a fully fledged market economy in the next two or three years. The country has a population of 2.2 million people, a land area three times that of France, and rich deposits of coal, gold, copper, tin, nickel, tungsten, phosphates and oil. Copper accounts for 25 per cent of exports. The processing of livestock and animal products, such as cashmere wool and carpets, are also a significant component of industrial output.

A new petroleum law, company law, customs law, and banking law were also enacted in 1991; a tax law in December 1990. In addition Mongolia is considering setting up special economic zones for foreign investors in the eastern region, where mineral resources and labour abound, and where there is a good infrastructure.

Ending Dependence on the Soviets

Mongolian industry was built almost entirely with Soviet technical and financial assistance. Completely landlocked, Soviet railways provided access to the sea at Nakhodka, 1,500 miles away. In 1990, 95 per cent — or $2 billion worth — of Mongolian trade was with the Soviet Union and Eastern Europe.

But these countries' shift to hard currency trade and the political upheaval of recent months has fuelled Mongolia's search for new partners. Relations with China are warming. Crossborder trade has boomed. Mongolia has been given access to the port of Tianjin, near Beijing, and a rail connection is under discussion.

Trade with Asia and the West amounted to $120 million in 1990, with Japan accounting for about a half. The main export is cashmere wool. Mongolia plans to become a source of raw metals like silicon to high-tech micro-electronics and optics industries in neighbouring Asian countries.

Cushioned between the Commonwealth of Independent States and China, Mongolia is an ideal location for investors wishing to export into those countries. Also available to them would be local officials' detailed knowledge of the former Soviet market.

Oil and Minerals the Real Draw

Partly to improve the conditions for foreign business, the Government is concentrating on improving the communications infrastructure and financial services. The country recently became a member of an Asian satellite communications system that enables communications with 195 countries by telephone, telex and fax. Independent air links are being initiated with a number of countries, among them Japan and the

Republic of Korea. Mongolia is also moving to make its currency, the tugrik, freely convertible on the foreign exchange market.

As yet just $2 million dollars have been invested. But a number of investors are showing interest in Mongolia's oil and mineral resources. The Government has opened 12 blocks for petroleum exploration on the border with China. Western Geophysical and AIE, both US firms, are conducting geological studies.

Sixty-five per cent of all state enterprises will be up for sale in the next few years.

Japanese joint ventures include an iron and steel plant, a cashmere wool combine and the production of medical equipment and colour televisions. There are also a number of projects in livestock breeding, biotechnology and dairy processing.

Some regional projects are also under discussion. Mostly they centre on the processing of mineral resources and oil from the Soviet Far East and Mongolia, for sale to the Republic of Korea and Japan.

Key to successful restructuring will be the training of indigenous manpower. Few Mongolians are familiar with capitalist concepts, business practices or the latest technologies. The Government has approached CTC for assistance in training officials on foreign direct investment and technology transfer issues, in export promotion and in drafting legislation on foreign participation in mining. In addition a database on transnationals has been requested, to evaluate and monitor joint venture partners. ■

Public-Private Sector Synergies

(Continued from page 1)

and programme coordination, will head the consolidated Division. "More and more, effective public sector mechanisms are an important complement to more dynamic private sector involvement", says the Harvard Business School trained administrator. "Priority will be given to helping Governments revise investment legislation, reform administrative structures, improve financial management, strengthen financial markets and encourage entrepreneurship. The new division will seek to integrate public sector and private sector trends in a productive manner, through research, analysis and technical cooperation." ■

Investment Flows

(Continued from page 2)

transnationals began to consolidate their positions within the developed economies as they approached desired capital positions. A decline in world-wide merger-and-acquisition activity — a result of slower growth, rising equity market valuations and uncertainties in financial markets — may have also exerted a dampening influence on inflows of foreign direct investment.

Global Distribution Still Skewed

Developing countries received inflows of $32 billion in 1990, accounting for approximately 17 per cent of all investment inflows.

Continuing earlier trends, the 10 largest host developing economies — Argentina, Brazil, China, Egypt, Hong Kong, Mexico, Malaysia, Singapore, Taiwan Province of China and Thailand — received approximately two thirds of all developing country inflows. Asia attracted 61 per cent. A significant departure from the mid-1980s was the strong growth of inward investment in Latin America and the Caribbean in 1990, increasing their share to 32 per cent.

Eastern Europe

Despite growing inflows to Central and Eastern Europe, the region's share of world-wide investment remained relatively small. Between the end of 1990 and June 1991, the number of joint ventures doubled to reach a total of about 25,300 with foreign equity participation of approximately $9 billion. Possible "first-comer" advantages and long-term prospects have already induced many companies to invest there, even if no returns materialize in the short run.

Present investment levels in Central and Eastern Europe could expand significantly though. By one estimate, cumulative foreign direct investment in the region could rise to $75-$100 billion by the late 1990s. Natural resource availability, skilled labour, relatively low labour costs, large potential markets and the proximity to Western Europe make these countries attractive to foreign investors. Prospects will depend largely on the success of market reforms and the commitment by Western countries to providing financial and technical assistance. ■

Foreign investment in Central and Eastern Europe could rise to $100 billion by the late 1990s.

NEW PUBLICATIONS

Bank Reform Assists Debt Reduction

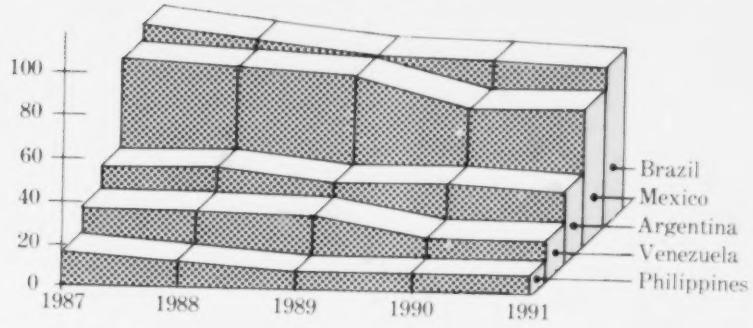
In the last three years, developing countries' commercial debt decreased by $20 billion. This was due partly to more favourable global economic conditions and renegotiated agreements with the banks. But adjustments in bank rules in creditor countries also played a key role, according to a recent study on the effects of regulatory reform in inducing banks to participate in debt relief programmes.

Particularly important were changes in capital adequacy rules, and in how loan-loss reserves and debt-restructuring instruments are accounted for and taxed. They determine how debt-related financial transactions affect a bank's capital position and its profit and loss account.

Differences in the regulatory frameworks of creditor countries, in conjunction with local economic conditions, created differing incentives for transnational banks to participate in debt-reduction strategies, says the study. In the United States, for example, more flexible capital adequacy rules, loan sales and charge-offs have significantly reduced the ratio of developing country debt to total assets. Banks are more willing to write-off bad debt. In Japan, difficulties in raising new equity to meet capital adequacy ratios are nudging banks to sell developing country assets on the secondary markets.

Declining Bank Claims on Debtors

(Millions of dollars)



Further changes might encourage more participation. To make it easier for the banks to make new loans, suggests the study, required reserves should vary for debtors that have kept servicing debt and those who have not. As yet, a 100 per cent risk-weight is applied to all long-term claims on developing countries. Governments could give tax breaks for discounted debt sales that provide relief to debtors. New money might require fewer reserves than existing assets. And to prevent banks from free-riding in restructuring or refinancing agreements, banks that do not discount debt or provide new loans should be required to increase non-tax-deductible reserves against developing country claims.

Regulatory modifications can only generate the incentives for transnational banks to participate in debt-relief transactions, says the study. How vigorously banks take part will depend on the political commitment of creditor countries. ■

Transnational Banks and the External Indebtedness of Developing Countries. United Nations publication, Sales No. E.92.II.A.10. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.

The Centre on Transnational Corporations is part of the Transnational Corporations and Management Division in the United Nations Department of Economic and Social Development. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, the Centre seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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Editor: Khalil Hamdani.

Associate Editor: Premila Nazareth. Assistant Editor: Christopher Smith.

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Centre on
Transnational Corporations
2 United Nations Plaza
New York, NY 10017, USA